The Office of Tax Simplification review of the taxation of property income: CIOT, LITRG and ATT respond

General Features | Personal tax

21 June 2022

The Office of Tax Simplification is reviewing aspects of property income taxation that are complex and hard to get right. CIOT, LITRG and ATT have responded to the call for evidence.

CIOT's response

The Office of Tax Simplification (OTS) joined the CIOT's Property Taxes Committee meeting in March to discuss the current regimes for the taxation of residential property held by individuals, partnerships and micro companies. The review's primary focus is on income received from property. We followed the discussion with a detailed written response (www.tax.org.uk/ref936).

The receipt of property income encompasses an extremely wide range of activities and provides its own complexities and distinctions that are not always present when considering income from other investments; for example, the dividing lines between various types of rental accommodation are quite fine and have become increasingly fluid.

We noted the restriction on deductibility of funding costs for individuals, partnerships of individuals and trustees, but not for corporates or corporate partnerships. This undermines the principle of neutrality, promoting one form over another for tax purposes and thereby potentially distorting the economic choice of structure. It is not clear whether the underlying policy behind the restriction on deductibility, broadly to promote owner-occupier purchasers in the long term, has been delivered as, in many cases, we understand that owners simply transferred their investment properties to corporate vehicles.

Furthermore the policy of promoting owner-occupation is not necessarily consistent across the different regimes; for example, the availability of a full deduction for loan interest under the furnished holiday lets (FHL) regime may favour investment in holiday lets in geographic areas in competition with owner-occupiers, including first-time buyers.

We do not think it is helpful in terms of consistency and ease of understanding that, between different taxes, HMRC consider that property letting can be a business for one purpose and not for another, or that what constitutes a property business as opposed to a passive investment is often a grey area.

We suggest that in view of the length of time that has elapsed since the introduction of the current FHL regime, and the wider societal changes that have occurred during that period, the current FHL regime should be reviewed by the government to ensure it is still meeting policy objectives. The FHL regime has complexities, particularly in the treatment of losses and capital allowances. However, the day-count test provides certainty of tax status, albeit that those tests do not align with the tests for holiday accommodation falling within business rates (instead

of council tax) and therefore benefiting from small business rates relief.

For income tax purposes, spouses or civil partners living together are assessed on income from jointly held property ('the 50:50 rule'). In our response, we consider the question of whether there is still a need for this deeming provision for income tax purposes 30 years after independent taxation was introduced and 140 years after the Married Women's Property Act 1882.

In terms of assisting landlords in understanding their tax obligations, it may be feasible for letting agents, platform operators or holiday rental agencies to point to appropriate guidance on GOV.UK but there are several practical obstacles to letting agents and others providing data to HMRC. We remain concerned about lack of awareness of the start of Making Tax Digital for Income Tax in April 2024, particularly among 'accidental' landlords (a landlord who did not acquire the property with a view to letting; for example, on inheritance or because of the inability to sell a former residence following a change in circumstances) or landlords holding only one property.

We also pointed to a lack of understanding by some UK residents with overseas property income of what is declarable to the UK authorities and what deductions can be made for taxes paid overseas. The difference between the UK tax year and the tax year of the overseas state (more often than not the calendar year) exacerbates these issues.

We also noted that in the absence of an agent, a third party tenant wholly unconnected to the non-resident landlord may have no knowledge or means of establishing that deduction of tax is required, or even that their landlord is 'non-resident'. We suspect that few tenants, especially those who have no connection with the landlord beyond that of the landlord/tenant relationship, are likely to become aware of these obligations.

LITRG's response

The Low Incomes Tax Reform Group (LITRG) joined the CIOT in meeting with the OTS to discuss their call for evidence for their review of property income, highlighting the issues faced by unrepresented taxpayers. The discussion was followed up with a written submission.

In our submission, we point out that lower income taxpayers may receive property income for a variety of reasons and that property rental is not merely an income stream of the wealthy. For this lower income and/or unrepresented population, we have expressed concern that there is a lack of clear (yet suitably detailed) public-facing guidance on GOV.UK, even at a basic level; for example, on establishing Self Assessment registration requirements.

We feel this lack of effective guidance is made worse when considering that some areas of tax legislation related to property can be particularly complex in nature; for instance, the furnished holiday let regime, distinguishing between capital and revenue expenditure, and overseas tax interactions. Our response explains that these more complex areas are just as likely to touch lower income and unrepresented taxpayers. Our experience suggests that these taxpayers can be left feeling daunted and confused, which in turn can lead to instances of non-compliance and incorrect submissions.

As ever, we continue to insist that digital capabilities of unrepresented taxpayers must be borne in mind, and that taxpayers who are less digitally confident must be supported and, if necessary, provided with alternative methods to remain compliant.

LITRG's submission can be found here: www.litrg.org.uk/ref2640

ATT's response

The ATT met with the OTS on 8 June to discuss our response to the call for evidence. In common with CIOT, we expressed some concerns over the lack of clarity over the dividing line between business and investment and over the merits of continuing to provide tax-favoured status for FHLs. We also raised concerns about MTD and the challenges this will produce for less digitally confident landlords. There is no obvious benefit for them (and in fact a significant burden) in respect of quarterly reporting.

We raised additional concerns around specific areas such as the lack of understanding and/or the proper use of Form 17 and questioned whether it remained relevant. We also flagged some unclear guidance on record keeping in respect of the property allowance. Interestingly, all of our volunteers in our meeting were in the process of correcting the affairs of individuals who had recently come to them having failed to report property income over a number of years, suggesting that there remain significant issues over registration and engagement with the tax system by some people with property income.

Antonia Stokes *astokes@litrg.org.uk*

Kate Willis *kwillis@ciot.org.uk*

Helen Thornley *hthornley@att.org.uk*